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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of Return Regulation	)	CC Docket No. 98-77
	)	

REPLY COMMENTS OF THE SBC COMPANIES

SBC Communications Inc. (SBC), on behalf of Southwestern Bell Telephone Company (SWBT), Pacific Bell, and Nevada Bell (collectively, the SBC Companies) and pursuant to the Notice of Proposed Rulemaking (NPRM) released June 4, 1998 by the Federal Communications Commission (Commission), hereby responds to the comments filed August 17, 1998 by MCI Telecommunications Corporation (MCI) regarding the price cap local exchange carrier (LEC) access reform proceedings.[1]

MCI suggests that the Commission should bring to resolution all outstanding issues involving price cap LECs before it proceeds with access reform for rate-of return LECs. These issues include: prescription of price cap LECs access charges to forward looking economic cost (page 4), completion of universal service reform (page 7) and the definition of primary and non-primary residential lines (page 9). While SBC agrees that

[1] While the MCI comments are ostensibly filed in the CC Docket 98-77 proceedings, MCI addresses the first substantive section of those comments to the price cap LEC access reform proceeding. SBC, representing three price cap LECs, hereby responds to that section alone. This limitation should not be taken as indicating any approval or agreement with any of the other arguments in the MCI comments.

the Commission should expediently pursue completion of price cap LEC access charge reform, and Universal Service Reform, MCI's suggestions are misplaced in this proceeding, and mostly wrong besides.

I. The Commission Should Not Prescribe Access Charges Based On Forward Looking Cost Studies.

In arguing that the Commission should prescribe access charges based on forward looking cost studies, MCI completely ignores the basic premise of price cap regulation. The Commission has recognized as recently as June 1, 1998[2] that:

> price cap regulation, unlike rate of return regulation, is designed to focus on the prices that carriers can charge for their services, as opposed to the carriers' cost and authorized rate of return . . rates have diverged from stet costs over time through operation of the price cap formulas.

Thus, not only is MCI's argument to prescriptively reduce price cap incumbent LEC (ILEC) access rates completely misplaced in this proceeding, it is contrary to the Commission's recent statements on rate regulation for price cap LECs.[3]

In CC Docket No. 96-262 (Access Charge Reform) MCI advanced similar arguments calling for prescriptive decreases of access charges to economic cost. The Commission unequivocally rejected the arguments and explained:

> [E]ven assuming that accurate forward-looking cost models were available, we are concerned that any attempt to move immediately to competitive prices for the remaining services would require dramatic cuts in access charges for some carriers. Such an action could result in a substantial decrease in revenue for incumbent LECs, which could prove highly disruptive to business operations, even when new explicit universal

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[2], Tariffs Implementing Access Charge Reform, Memorandum Opinion and Order, CC Docket No. 97-250, released June 1, 1998, at paragraph 72.

[3] MCI also conveniently ignores the quasi-prescriptive measure the Commission adopted in CC Docket No. 94-1 (Price Cap Review) by raising the productivity offset that resulted in access rate decreases. This prescriptive measure permanently lowered access rates by $1.7B in 1997, and will continue to drive rates down toward cost in years to come.

support mechanisms are taken into account. Moreover, lacking the tools for making accurate prescriptions, precipitous action could lead to significant errors in the level of access charge reductions necessary to reach competitive levels. That would further impede the development of competition in the local markets and disrupt existing services. Consequently, we strongly prefer to rely on the competitive pressures unleashed by the 1996 Act to make the necessary reductions.[4]

There is no reason for the Commission to change course. MCI asserts that the 8th Circuit Court's ruling against the Commission's unbundled network element (UNE) pricing guidelines and LEC recombining as the two main reasons why the Commission should revisit this decision. Asserting that competitive entry in local exchange markets is effectively precluded by the absence of "a requirement that the ILECs combine network elements,"[5] MCI warns the Commission that it "can no longer reasonably predict that competition will evolve sufficiently to drive access charges to cost."[6]

According to MCI's dire warning, only by forcing ILEC access charges to equal what MCI claims are the ILECs' "forward-looking economic costs" can the Commission safeguard "the only path of entry that still holds any promise for bringing competition to the local markets."[7] Nearly every point MCI presents with the apparent intention of alarming the Commission, however, is contrary to both generally accepted economic principles and sound economic analysis.

Absent a requirement that ILECs combine UNEs, MCI concludes "the scope for

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[4] Access Charge Reform, 12 FCC Rcd 15982 (1997) at para. 46 (Access Charge Reform Order).
[5] MCI Telecommunications Corporation, MCI Comments, CC Docket No. 98-77, In the Matter of Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation (August 17, 1998), p. 4
[6] MCI Comments, p. 5.
[7] MCI Comments, p. 7.

UNE-based competition is sharply reduced."[8] This conclusion can only be reached if the presence of alternative telecommunications suppliers profitably satisfying consumer demand by relying solely on ILEC investments in network capacity constitutes a truly competitive market.

Furthermore, failure to force ILECs to combine UNEs might raise concerns about the viability of potential competitors only if "UNE-based competition" is deemed a desirable permanent characteristic of the U.S. telecommunications industry. If the most efficient industry structure for satisfying consumer demand for local exchange telecommunications services is not a natural monopoly, then the presence of numerous suppliers vigorously competing against each other for market share will minimize both the industry cost structure and retail prices to consumers. Little change in the telecommunications industry's cost structure can be expected, however, if there is but a single supplier of the industry's entire productive capacity. Few of the benefits consumers typically derive from purchasing services in competitive markets will be forthcoming if a single supplier is expected to invest in network capacity, develop and deploy new technologies and services, and then make these assets available to "competitors" at prices reflecting what regulators expect will be the future costs of the firm.

Contrary to MCI's view, perhaps the legislative and regulatory initiatives establishing and implementing UNEs as a mechanism for granting competitors access to ILECs' network capacity are not aimed at creating long-term profits for firms seeking to permanently avoid the risks that accompany capital investment in productive network

[8] MCI Comments, p. 4.

capacity. Viewing UNEs as a means for temporarily augmenting the facilities of competitors whose networks are not yet complete is consistent with both a stated objective of encouraging facilities-based competition and avoiding requirements for ILECs to combine UNEs

Permitting competitors access to those components of ILEC networks which are difficult to duplicate for use in combination with competitors' own facilities might be considered a viable (regardless of how ineffective it is likely to be) method for "jump-starting" facilities-based competition by some policy makers. Avoiding requirements for ILECs to combine UNEs is consistent with policies aimed at encouraging facilities-based competition. Rather than the death-knell for competitive entry in local exchange markets, as MCI implies, the absence of a requirement for ILECs to combine UNEs is a logical component of a policy intended to create an industry in which rivals control the costs of operating their own productive facilities thereby increasing the potential for the cost and price reductions expected from the competitive process.

MCI also contends that failure to compel ILECs to combine UNEs destroys the ability of firms leasing UNEs to "constrain the pricing of access services."[9] Even if accurate, this contention is cause for concern only if the federal price cap rules and both state and federal general regulatory processes are all presumed impotent.[10]

Furthermore, it is not certain that requiring ILECs to combine UNEs will "constrain the pricing of access services" in any case. To the extent interexchange

[9] MCI Comments, p. 5.

[10] The ability of regulation to significantly alter ILEC prices by what are effectively prescriptive means is demonstrated by the substantial interstate access charge reductions driven by Commission decisions to increase the productivity offset factor and thereby

carriers (IXCs), including MCI, would likely simply substitute combinations of ILEC UNEs for current access services to take advantage of substantially lower prices, requiring ILECs to combine UNEs simply creates an opportunity for tariff shopping rather than a competitive mechanism capable of lowering industry costs and market prices to end users. It is likely that requiring ILECs to combine UNEs will have the same impact on IXCs' decisions to compete against ILECs in providing local exchange services as all prior access charge reductions have had.

From this viewpoint, MCI's request for the Commission to prescribe ILEC access charge reductions is a perfect substitute for requiring ILECs to combine UNEs. Any stated concerns about encouraging and safeguarding competition in telecommunications markets becomes irrelevant to the objective of reducing ILEC access charges. Even a prescriptive dramatic reduction in ILEC access charges will likely produce only a slight, if any, change in the current competitive status of telecommunications markets.

Although MCI clearly considers ILEC access charges excessively high, prevailing prices are obviously not sufficient to produce profit levels high enough to spur widespread competitive entry in local exchange markets. By prescribing a reduction in ILEC access charges to levels sufficient to recover only the incremental cost of providing those services, the Commission will effectively deter potential entry and reinforce the reluctance of IXCs to construct local exchange networks and thereby facilitate ILEC entry into interLATA long distance markets. If IXCs could self-supply access services by constructing network facilities at incremental costs significantly below prevailing ILEC access charges, presumably this profit motive would compel IXC entry in local exchange

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lower the caps imposed on ILEC rates.

markets. Since few, if any, such IXC construction programs are underway, it is likely this reluctance to deploy local exchange facilities would be significantly strengthened by a Commission decision to prescribe ILEC access charges equal to incremental cost. Thus, the Commission will not be enhancing the potential for competitive entry in local exchange markets by prescribing ILEC access charges equal to incremental cost.

With ILECs being increasingly accused of deterring entry by setting prices anticompetitively low, MCI adopts a novel approach by claiming ILEC access charges are so high they constitute a barrier to entry.[11] Since access charges are the same for all IXCs, it is likely this input cost is recovered by passing it along to end users in the retail prices of toll services. With access charges tariffed and invariant between carriers, incorporating this cost into retail prices will not alter the relative prices of the various carriers' services. It is not clear how the cost of an input recovered in a similar fashion by all industry participants unduly constrains the financial resources of any one of the firms purchasing the input.

Nevertheless, the clear implication of MCI's overall strategy is to convince the Commission that if a substantial reduction in ILEC access charges is prescribed, MCI and presumably all, or at least most, other IXCs will not pass this cost savings along to consumers by lowering retail long distance prices. Instead, the increased profits resulting from the proposed cost reduction will be accumulated until MCI (and presumably other IXCs) feel confident they possess sufficient financial resources to begin constructing

[11] According to MCI, excessively high ILEC access charges "constrain the financial resources available for interexchange carriers to enter local markets." (MCI Comments, p. 3.)

local exchange facilities and providing local service in competition with ILECs.[12] MCI's claim that ILEC access charges are so high as to constitute a barrier to entry thus appears to be a weak attempt at disguising a strategy that could effectively delay competitive entry in telecommunications markets generally

MCI's implication (that if the Commission prescribes substantial reductions in ILEC access charges, IXCs will accumulate the cost savings until they have sufficient investment capital to successfully enter local exchange markets) conflicts with the generally proclaimed competitive conditions in long distance markets. If long distance markets are intensely competitive with strong rivalry between IXCs for even small changes in relative market shares, it is difficult to accept MCI's implication that such rivals would act in concert in accumulating investment funds. In such a vigorously competitive environment. surely at least one firm can be expected to pass along at least some portion of any cost saving to consumers by lowering prices and attempting to capture market share from its rivals. Either MCI's entire proposition is inconsistent with economic reality and therefore should be unacceptable to the Commission or the long distance market is characterized by substantially more cooperation between suppliers than previously acknowledged by the Commission. In either case, the propositions presented by MCI should not be seriously considered as sufficient justification for the Commission to conclude cost study methods or the interpretation of cost model results are superior to

[12] The length of time necessary for MCI to hoard sufficient wealth will be determined solely by itself. Other IXCs can reasonably be expected to require a similar length of time to accumulate an adequate stockpile of investment capital. During this IXC wealth-hoarding period, it is unlikely local exchange markets will be deemed sufficiently competitive to sanction ILEC interLATA entry.

consumer demand, other market forces, and the constraints inherent in price cap regulation in determining appropriate ILEC prices

MCI's allegations also completely ignore the competitive LECs' (CLECs') option for resale as a means of replicating ILEC services. MCI goes on to bemoan the fact that the only viable means of local entry for CLECs entails investment in their own facilities. Resale of total service offerings requires no capital investment on the part of the CLEC and allows for immediate entry into local exchange markets. At best, it would have been redundant for the Court to uphold the decision that ordered ILECs to recombine UNEs; that is the very function of resale. If recombining were required for UNEs, it would only serve to create an arbitrage opportunity for CLECs against the resale alternative.

In any event, even though the 8th Circuit struck the Commission's pricing rules and left UNE pricing oversight to the States, UNE pricing still generally adheres to the formula-based method outlined by the Commission. SBC disagrees with MCI's unsubstantiated insinuation that UNE prices are not grounded in forward-looking economic cost. The states served by SBC LECs have generally followed the original Commission TELRIC standard, inextricably linking UNE prices to forward-looking economic cost.

II. Universal Service Reform and Implementation of Access Charge Reform

MCI calls for the Commission to determine the final definition of primary and non-primary residential lines. SBC completely agrees. Sixteen months after the Commission release of the Access Charge Reform Order, no final definition of primary and non-primary residential lines exists. This lack of a firm, final definition has led to a waste of the Commission's and the industry's resources, due to the continual discussions, errata filings and orders issued while all parties continue to guess the final definition.

CONCLUSION

For the foregoing reasons, the SBC Companies respectfully request that the Commission expeditiously move to complete access charge reform for Price Cap LECs as well as Universal Service Reform but that the Commission should reject the MCI recommendations on how to do so.

Respectfully submitted,

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September 17, 1998

Certificate of Service

I, Mary Ann Morris, hereby certify that the foregoing "Reply Comments of SBC communications, Inc." in CC Docket Number 98-77 has been served on September 17, 1998, to the Parties of Record.

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September 17, 1998

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